



This case was far from a typical tax case. In fact, no taxing authority was a party to the litigation. The case involved a contract dispute in which a vaguely defined hypothetical situation had to be analyzed by a U.K. court. The U.K. court had to interpret Indonesian tax law, as potentially modified by the Indonesia-Netherlands Tax Convention, to determine whether a party to the contract took sufficient measures to avoid taxation. The case was summarized in *Prévost Car Inc. v. The Queen* (2008 T.C.C. 231):

An Indonesian company, Indofood ("Parent"), set up a Mauritian special purpose vehicle ("Issuer") to issue loan notes. Back to back loans were put in place. The loan notes contained a gross-up clause and provided for early redemption in case that, due to tax or treaty changes, the Issuer had to pay additional tax. The notes also contained a clause requiring the Issuer to try to mitigate any additional tax liability by "taking reasonable measures available to it" before seeking to redeem the notes. The financing was structured via Mauritius to avail of the beneficial withholding tax rates under the Indonesia-Mauritius Double Tax Treaty. Mauritius has no outbound withholding taxes.

As a result of abuse of the treaty by conduit companies, Indonesia terminated its tax treaty with Mauritius effective January 1, 2005, thus increasing to 20 percent the withholding on the interest payments between the Parent and the Issuer. In other words, the gross-up, instead of being 10 percent became 20 percent under domestic Indonesian law. Since the issue of the notes in 2002, both interest and exchange rates had moved against the Parent and in favour of the noteholders. The Parent, therefore, sought to redeem the notes and refinance more cheaply. However, JP Morgan Chase (the "Defendant") acting as trustee for the bondholders was not satisfied that the best endeavours clause had been complied with, alleged that Indofood could have interposed a Dutch entity ("Newco") into their structure and availed of the preferable rates under the Netherlands-Indonesia Double Taxation Convention. Therefore, the Defendant refused to approve the redemption.

The main substantive issue at trial was whether Newco would be the beneficial owner of the interest payable to it by the Parent for the purposes of the reduced withholding tax rate in Article 11 of the Indonesia-Netherlands Tax Convention.

The court in *Indofood* quoted the OECD report entitled "Double Tax Convention and the Use of Conduit Companies" as follows:

[A] conduit company can normally not be regarded as the beneficial owner if, though the formal owner of certain assets, it has very narrow powers which render it a mere fiduciary or an administrator acting on account of the interested parties.

The timing of the required cash flows for interest payments from Parent to Issuer and from Issuer to the bond holders was tight, and there was no profit or "spread" at Issuer. The U.K. Court of Appeal found unanimously for Indofood, that the Issuer was not the beneficial owner and, if interposed, Newco could not be the beneficial owner of the interest received from the Parent. The court stated that "the position of the Issuer and Newco equates to that of an 'administrator of the income.'"